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***Scott v HMRC*: principles, policies and interpretation**

Introduction

A poet cannot dictate how their poem should be read. Once the words are published to the world, they lack the authority to determine the poem's meaning. That is not to say that the poet's subjective intention should be disregarded, indeed it may provide context for how the poem should be read. Critically though, the words become alienated from the author's control. This too is the general case with regard to words in statutes subject to the narrow exception established in *Pepper (Inspector of Taxes) v Hart*.¹ What the sponsoring minister states about a Bill generally provides no more than context. The meaning and hence the underlying purpose of the statute, in other words the content of the rules, should be derived from a close reading of the text.

This separation of the context from the content of words in a statute is one principle of statutory construction which underpinned the judgment of the Upper Tribunal (UT) in *Scott v HMRC (Scott v HMRC (UT))*.² The other principle is that, when searching for the purpose of words in a statute, the tribunals and courts will seek to interpret legislation in a manner which brings coherence to the law. When these two principles are combined, as demonstrated by HMRC's success before both the First-tier Tribunal (FTT)³ and the UT in *Scott v HMRC*, a taxpayer will struggle to convince a tribunal or court that a broad policy goal mentioned in a ministerial statement should be used in order to produce what approaches incoherence across statutory provisions.

Further, the case illustrates the inefficiency of the limitation on public law issues being heard by the FTT, something analysed by the writer in an earlier issue of this *Review*.⁴

Facts and judgment

There is little to mention in terms of the facts in *Scott v HMRC (UT)* as the parties agreed the relevant quanta. The only issue that the UT had to decide was one of principle, namely what would be the tax outcome of claiming an amount for Corresponding Deficiency Relief (CDR) on the termination of an insurance policy that is greater than a taxpayer's income. This in turn would have a bearing on the rate of tax on unrelated capital gains that the taxpayer should pay. However, a read through the judgment of the FTT reveals that the taxpayer was a man of considerable means, who was claiming a large amount in respect of CDR⁵ and thus this matter of principle was of considerable practical significance.

By way of background, section 4 of the Taxation of Chargeable Gains Act 1992 (TCGA) dictates the rate at which tax is charged on capital gains, which in turn is linked to the rate at which income tax is charged. The general rule in respect of an individual is that if the taxpayer is subject in a given year to the higher rate of tax on any part of their income, then chargeable gains will also be subject to the higher rate applicable to gains (now 20 per cent).⁶ To the extent that the taxpayer's income does not reach the top of the income tax basic rate band, their capital gains are charged at the lower rate of, now, 10 per cent.⁷ The effect is to reduce disparity in the treatment of capital gains and income.

¹ *Pepper (Inspector of Taxes) v Hart* [1993] AC 593; [1992] STC 898 (HL).

² *Andrew Scott v HMRC* [2018] UKUT 236 (TCC).

³ *Andrew Scott v HMRC (Scott v HMRC (FTT))* [2017] UKFTT 385 (TC); [2017] STI 1616.

⁴ S. Daly, "Public Law in the Tax Tribunals and the Case for Reform" [2018] BTR 94.

⁵ See for instance *Scott v HMRC (FTT)*, above fn.3, [2017] UKFTT 385 (TC), Appendix 1 at [8] where it is stated that the taxpayer's total income for those two years was circa £45 million and that CDR of circa £20 million was being claimed.

⁶ Or 28% if the gains are residential property gains: TCGA s.4(4).

⁷ TCGA s.4(2)(b).

Meanwhile, gains on life insurance policies are treated as income in the hands of the policyholder.⁸ When the policy comes to an end the computation of the final gain may result in a negative amount⁹ and there will be no tax on the termination of the policy in this event. However, if, during the term of the policy, previous gains have been chargeable as income, CDR may provide some relief against *other* income or gains taxed in the year of the termination of the policy. CDR is, accordingly, a relief on income tax but does not operate like usual reliefs in the sense that it does not reduce the taxable income of a taxpayer, but rather it reduces the amount of income which is subject to the higher rate of tax.¹⁰ In other words, it does not affect the quantum which is chargeable to tax, but it does affect the rate which is to be applied. Section 6(2) TCGA, which was operative in the tax years concerned in the case and which was subsequently replaced by section 4A TCGA, provided a means of using the relief in conjunction with capital gains.

If the income reduced by CDR results in a figure which is below the top of the basic rate band, this produces a portion of unused basic rate band. Any capital gains within the band would be charged at the lower rate. *Scott v HMRC* (UT), however, turned on what should be the outcome where the CDR claimed *exceeds* the income in that year. In this event, either that excess, in addition to the amount of the basic rate band, should be available to set against any capital gains taxable at the higher rate (the taxpayer's argument)¹¹ or the excess should be ignored for the purpose of calculating the rate for capital gains (HMRC's argument).¹² A component of the taxpayer's argument was that the effect of the relevant provisions was simply to extend the basic rate band by the amount of CDR claimed and thus any unused part of that augmented band could be used in respect of any capital gains.¹³

Although the dispute related only to two tax years (2006–2007 and 2007–2008) and the essential arguments of the parties remained the same, the case was slightly complicated by the fact that different sets of statutory provisions applied to the different years owing to the interposition of the Law Rewrite Project (Rewrite) and the Income Tax Act 2007.

The UT agreed with HMRC,¹⁴ thereby upholding the decision of the FTT. First, CDR should operate like any other relief or allowance and as such it should not be possible to produce a negative income figure after applying it.¹⁵ There was nothing to be found in the statutory language to suggest it should be different.¹⁶ Instead the Rewrite explicitly provided in its Explanatory Notes that a “deduction can only be made from income to the extent that there is income to absorb the deduction”.¹⁷ Secondly, section 6(2) TCGA protected the benefit of the basic rate band by leaving out of account any income not brought into account for higher rate income tax purposes.¹⁸ It did not extend the basic rate band. Thus, the maximum amount of basic rate band that could be used in calculating the rate applicable to capital gains would be the band itself.¹⁹ Thirdly, if the result were otherwise, then that would mean that a relief on income tax provided in the income tax legislation would in effect be available as a

⁸ ITTOIA s.461.

⁹ See HMRC, Internal Manual, *Insurance Policyholder Taxation Manual*, IPTM3860 (19 March 2016, updated 5 August 2016), available at: <https://www.gov.uk/hmrc-internal-manuals/insurance-policyholder-taxation-manual/iptm3860> [Accessed 8 October 2018] where it is explained that this will be the case if total benefits fall short of total deductions plus previous gains.

¹⁰ ITTOIA s.539.

¹¹ *Scott v HMRC* (UT), above fn.2, [2018] UKUT 236 (TCC) at [28].

¹² *Scott v HMRC* (UT), above fn.2, [2018] UKUT 236 (TCC) at [27].

¹³ *Scott v HMRC* (UT), above fn.2, [2018] UKUT 236 (TCC) at [30].

¹⁴ *Scott v HMRC* (UT), above fn.2, [2018] UKUT 236 (TCC) at [31] and [64].

¹⁵ *Scott v HMRC* (UT), above fn.2, [2018] UKUT 236 (TCC) at [32] and [60].

¹⁶ *Scott v HMRC* (UT), above fn.2, [2018] UKUT 236 (TCC) at [32].

¹⁷ *Scott v HMRC* (UT), above fn.2, [2018] UKUT 236 (TCC) at [60]. See Explanatory Notes to ITA 2007, s.25, para.110.

¹⁸ *Scott v HMRC* (UT), above fn.2, [2018] UKUT 236 (TCC) at [35].

¹⁹ *Scott v HMRC* (UT), above fn.2, [2018] UKUT 236 (TCC) at [35] and [58].

relief on capital gains.²⁰ Such a broad purpose could not be discerned from the legislation—it does not provide for a perfect integration of income tax and capital gains tax.²¹ The taxpayer’s argument was that the purpose of the legislation was to tax capital gains and income at the same marginal rate—but that interpretation would be inconsistent with the usual application of losses and reliefs.²² Fourthly, HMRC’s approach would align with the ordinary meaning of the provisions, whereby the meaning of basic rate band should be interpreted as that band of income which is taxed at the basic rate.²³ Curiously, the UT examined the arguments first on the basis of the earlier iteration of the legislation and then found that the later iteration had the same effect. Given that the Rewrite was supposed to clarify the law, one would have expected the starting point to be the rewritten and clearer rules.

Ultimately, the taxpayer’s argument hinged on the idea that the purpose of the legislation was to unify the tax rates on income and chargeable gains, relying inter alia upon the Budget speech of Nigel Lawson, the then Chancellor of the Exchequer, which accompanied the introduction of what is now section 4 TCGA.²⁴ The UT disagreed that such a general policy, which might underlie the provisions, could be elevated into a principle of interpretation.²⁵ Policies provide context, principles determine content. In this vein, Dworkin’s distinction between policies and principles may be recalled: policies provide goals, principles impose obligations.²⁶ It fell short similarly of satisfying the conditions set out in *Pepper v Hart*,²⁷ which established the limited circumstances in which reference to the parliamentary record is permissible for the purposes of constructing an Act. First, the legislation was not ambiguous; secondly, Nigel Lawson was not promoting a Bill at the time of the speech; and, finally, Nigel Lawson’s speech did not express an answer to the specific question at hand. Instead the UT found that the general principle underpinning the provisions was that the applications of reliefs and allowances should not produce a negative income.²⁸

Comments

It is difficult to disagree with the overall result in the case, given that the taxpayer’s case required a narrow reading of the provisions combined with some heavy reliance upon general statements made by Nigel Lawson. This note shall make three brief points about the case: the first relating to the principles of construction; the second stressing the importance of the judgment in terms of understanding the operation of the capital gains legislation; and the final point concerning the distinction between appeal and judicial review.

First, the UT took the correct approach to the relevance of Nigel Lawson’s speech, in that it could only be seen at best as setting the context but not the content of the legislation. In the “last untelevised [Budget] speech”²⁹ Nigel Lawson proposed that a gain should be “taxed at the income tax rate that would apply if it were the taxpayer’s marginal slice of income”³⁰ and thus proposed to bring “greater neutrality to the tax system”.³¹

The fact that there may be recourse to ministerial statements does not undermine the content/context distinction. This is recognised by the *Pepper v Hart* exception. It is possible for such statements to provide the content of rules, because “legislative intention is the

²⁰ *Scott v HMRC* (UT), above fn.2, [2018] UKUT 236 (TCC) at [35].

²¹ *Scott v HMRC* (UT), above fn.2, [2018] UKUT 236 (TCC) at [35].

²² *Scott v HMRC* (UT), above fn.2, [2018] UKUT 236 (TCC) at [35] and [60].

²³ *Scott v HMRC* (UT), above fn.2, [2018] UKUT 236 (TCC) at [37] and [57].

²⁴ *Scott v HMRC* (UT), above fn.2, [2018] UKUT 236 (TCC) at [65]–[71].

²⁵ See *Scott v HMRC* (UT), above fn.2, [2018] UKUT 236 (TCC) at [71] in particular.

²⁶ R. Dworkin, *Taking Rights Seriously*, Reprint edn (London: Bloomsbury Academic, 2013), 20.

²⁷ *Scott v HMRC* (UT), above fn.2, [2018] UKUT 236 (TCC) at [67]–[69].

²⁸ *Scott v HMRC* (UT), above fn.2, [2018] UKUT 236 (TCC) at [32] and [61].

²⁹ *Hansard*, HC Deb, Vol 129, col 993 (15 March 1988).

³⁰ *Hansard*, HC Deb, Vol 129, col 1005 (15 March 1988).

³¹ *Hansard*, HC Deb, Vol 129, col 1005 (15 March 1988).

product of the process that produces the text”,³² and as such ministerial statements “may or may not come to be recognised as acts of the legislature”.³³ But the problem for the taxpayer in the case is that the statements do not elaborate upon the specific content of the relevant provisions. They do not expound a general principle against which all provisions concerning the interaction of income and capital gains ought to be construed or, in this case specifically, how the rules concerning capital gains tax rates should interact with CDR. Instead, the speech provided little more than a broad Government intention. Nigel Lawson did not seek to bring *complete* neutrality to the treatment of income and capital gains—he could have done so by using express wording to that effect in the statute (though it is a task perhaps beyond the capacities of all but a Herculean Chancellor), but he did not signal such an intention. Even a cursory glance at the interrelationship between the taxation of capital gains and income will reveal continued myriad asymmetries. As noted by the FTT and accepted by the UT,³⁴ “the legislation does not provide for a perfect integration of income tax and CGT”.³⁵ If it were to be so, one would expect the legislation to “allow for reliefs from income tax to reduce capital gains and vice versa”.³⁶

Ultimately then the taxpayer failed to convince the Tribunal that the policy goal of neutrality could be elevated to a principle of construction. It provided context not content. As an aside, it is contestable whether neutrality in itself is a desirable goal. It is certainly desirable where the lack of neutrality is unjustified, but that only begs the question of what should be viewed as a legitimate justification.

In its search for principles of construction, the Tribunal instead favoured a reading of the legislation which would align with other similar provisions and thereby reduce complexity and confusion.³⁷ To this end, the Tribunal found that a general principle underpinned the provisions whereby reliefs and allowances could not give rise to a negative income.³⁸ This would mean that CDR would operate like any other relief or allowance rather than on its own terms. This reading is not without difficulty however. That CDR is itself anomalous, in that it does not reduce the quantum of taxable income as reliefs and allowances ordinarily do but rather affects tax rates, was swept aside by the Tribunal.³⁹

Secondly, aside from highlighting how tribunals and courts will construe the content of legislation, the case also contains an important discussion on key terms in the capital gains legislation thereby underlining the relevance of the case. It is clear now that the “basic rate band” means the limit below which income tax is chargeable at the lower rate and it cannot be extended beyond this amount. Further, the purpose of what is now section 4(5) TCGA has been authoritatively explained to be that the taxpayer may use for capital gains tax any part of their basic rate band that has not been used for income tax. Most importantly, the case determined that section 6(2) TCGA, now found in section 4A TCGA, may not be used in such a manner as to produce a negative income.

Finally, it should be noted that the taxpayer was unsuccessful in a separate judicial review hearing.⁴⁰ The essence of that case was that the taxpayer had a legitimate expectation that his gains would be subject to the lower rate of capital gains tax. This was on the basis of a calculation performed by the taxpayer (or more specifically by his advisers) using HMRC software.⁴¹ The High Court ultimately found that there was no representation sufficient to

³² J. Freedman, “Interpreting tax statutes: tax avoidance and the intention of Parliament” (2007) 123 LQR 53, 72.

³³ Freedman, above fn.32, 72.

³⁴ *Scott v HMRC* (UT), above fn.2, [2018] UKUT 236 (TCC) at [35].

³⁵ *Scott v HMRC* (FTT), above fn.3, [2017] UKFTT 385 (TC) at [94].

³⁶ *Scott v HMRC* (FTT), above fn.3, [2017] UKFTT 385 (TC) at [94].

³⁷ On this, see T.R.S. Allan, *The Sovereignty of Law: Freedom, Constitution and Common Law* (Oxford: OUP, 2013), 5.

³⁸ *Scott v HMRC* (UT), above fn.2, [2018] UKUT 236 (TCC) at [32] and [61].

³⁹ *Scott v HMRC* (UT), above fn.2, [2018] UKUT 236 (TCC) at [32].

⁴⁰ *R. (on the application of Scott) v HMRC* (R. (Scott) v HMRC) [2015] EWHC 2810 (Admin).

⁴¹ *R. (Scott) v HMRC*, above fn.40, [2015] EWHC 2810 (Admin) at [7].

give rise to a legitimate expectation,⁴² but even if there had been such representation HMRC would be justified in frustrating the expectation given the large amounts of tax at stake.⁴³ But had the taxpayer succeeded in the judicial review, then the substantive appeal would have been redundant and vice versa. As this writer has argued in an earlier article in this *Review*,⁴⁴ it is entirely inefficient for there to be two parallel cases in such an instance when the case could collapse on the resolution of either dispute.

Stephen Daly**

⁴² *R. (Scott) v HMRC*, above fn.40, [2015] EWHC 2810 (Admin) at [11]–[13].

⁴³ *R. (Scott) v HMRC*, above fn.40, [2015] EWHC 2810 (Admin) at [15].

⁴⁴ Daly, above fn.4.

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